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Sandra Dearden, President & CEO

June 16, 2011

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Honorable Cynthia R. Brown
Chief, Section of Administration
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423

RE: STB Docket No. Ex Parte 705, Competition in the Railroad Industry

Dear Ms. Brown:

Attached are my oral arguments to be presented at the hearing scheduled for June 22 - 23, 2011.

Sincerely,


Sandra J. Dearden
President & CEO

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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

**TESTIMONY OF
HIGHROAD CONSULTING, LTD.**

**Sandra J. Dearden
Highroad Consulting, Ltd.
55 East Jackson Blvd., Suite 625
Chicago, IL 60604
(312) 765-0250**

June 10, 2011

I. Introduction

My name is Sandra Dearden, I am President of Highroad Consulting, Ltd., headquartered in Chicago, IL.

I. The State of Competition in the Railroad Industry

One of the participants in this proceeding opined that there is no competition in the railroad industry¹. However, I have seen evidence that railroads can focus on the customer and some railroad sales and marketing personnel seem to have the zeal to win business, but other carriers and even business units within the same company have adopted an abrasive and abusive approach to customers, even if it means losing business. As presented in my Reply Comments², competition in the railroad industry and the railroads' approach to customers is inconsistent at best.

I would like to share with you, two conversations that set off alarms and caused me to conclude that the state of competition in the railroad industry has changed and competition is inadequate.

One of our clients asked us to perform an assessment of his transportation operations with the objective to identify opportunities to improve efficiency of operations. At the time, and still to this day, that manufacturing plant is captive to one railroad, even though there are two other Class I railroads within five miles of the plant. I met with Industrial Development personnel of the two railroads and confirmed it was feasible and practicable for at least one railroad to build in to serve our client. However, soon after the second meeting with Industrial Development personnel, a senior marketing officer from the railroad called me and told me that

¹ Initial Comments of Olin Corporation, p. 5

² Reply Comments of Highroad Consulting, Ltd., p.6

they would not be willing to compete for the business because his railroad was more vulnerable to the serving railroad (relative to build-ins) than the serving railroad was to his.

The second conversation with a railroad marketing officer took place several years ago. He informed me that things have changed, that his company had concluded that in most cases, it is not in their best interest to participate in head-to-head competition because the end result is business shifts and they simply end up handling the same amount of business for lower revenues.

Frequently, we encounter situations where it seems the railroads have decided it is not in their best interests to compete. One indicator is the recent trend to force customers to tariff rates. Because they are public rates, the rates are posted on the railroads' websites which gives their competitors the ability to confirm their rates when competing, or deciding not to compete, for business. Examples include lanes where two carriers have the ability to operate from origin to destination, single line. We have negotiated rates in lanes with competing carriers. The railroads turned down our requests to establish the rates in contracts forcing our clients to tariff. When we requested the rates be established in private, non-distribution tariffs, they also turned down those requests. The only conclusion we could reach was this is the railroads' way to signal their competition so they can control future pricing.

II. Rate Reasonableness Standards

The railroads contend we do not need competition so long as we have

regulation.³ First, this seems to imply that the railroads concede the point that competition is inadequate. Also, while they submit they do not like regulation, on the other hand they contend regulation is a good substitute for competition.

We commend the Board for progress made with development of procedures enabling "small" shippers to file complaints and to seek relief from unreasonable rates. However, even though the timelines and associated litigation costs have been reduced, even the Small Rate Case and Simplified SAC procedures are not practical solutions for most small shippers. The current limits and potential benefits from prescriptions compared to litigation costs have precluded shippers from filing rate cases. Also, the inclusion of the 3-benchmark process is one of the reasons that rail shippers have elected to file Stand-Alone rate cases. (If the railroad is assessing extremely high, unreasonable rates, against all shippers, then the 3-benchmark analysis does not contribute to the shipper's case).

We all know that a large, SAC case is only an option for very large shippers with high volumes, but large shippers are also wary of filing rate cases because they incur the additional expense of paying tariff rates for more than three years. One of our clients, a very large rail shipper, estimated the cost of filing a SAC case would exceed \$80 million – quite a gamble. On the other hand, the railroads seem to be willing to assume the risk and expense, probably because their costs associated with defending a rate case are offset to some extent when the customer is forced to higher tariff rates.

³ BNSF Comments at 3, AAR Comments at 13. Reply Comments of CSX, p.8

Finally, as submitted in the previous URCS proceeding, the URCS cost model requires update or replacement.⁴ Using the URCS model to measure rate reasonableness is very unfair to the shippers as the costs do not reflect contemporary railroad operations. This is a very important issue and the decision regarding methods to replace or modify URCS should not be based solely on least cost alternatives.

III. Reciprocal Switching

Recently, it has come to my attention that there have been instances where carriers have terminated reciprocal switching operations, thereby closing the industries to reciprocal switching, without notice or process. We submit termination of reciprocal switching arrangements should be subject to Board approval. Standards should be established and the railroad seeking termination of reciprocal switching arrangements should be required to comply with the standards and to show just cause.

IV. Unreasonable Practices

As stated previously, competition in the railroad industry is inadequate so the railroads sometimes force decisions simply because they can. As a result, unfair practices develop. I will focus my comments on a few examples and refer you to more detailed information set forth in my reply comments.

Mileage Equalization - A group of shippers filed a petition with the STB, asking the Board to determine the reasonableness of the calculation of mileage

⁴ Comments submitted of Highroad Consulting, Ltd. regarding review of the Surface Transportation Board's General Costing System, STB Ex Parte No 431, (Sub No. 3)

equalization charges⁵. We support the Complainants' position in this proceeding. In most cases, charges for mileage equalization develop because the railroads move via alternative routes for railroad convenience. Movement of the empty cars via reverse routes is already included in the calculation of costs for the loaded moves. Shippers should not be required to subsidize the railroads if the cars are moving via other routes for railroad convenience. We encourage the Board to review this unreasonable practice and the impact it has on all tank car owners and shippers.

Fuel Surcharges – Fuel surcharges continue to be a problem, they continue to be profit centers for the railroads, and shippers are required to pay surcharges that have no relationship to the freight they are shipping. Therefore, in accordance with the Board's decision in STB Docket Ex Parte No. 661, they constitute an unreasonable practice.

One of the problems with the railroads' fuel surcharge programs is the way they apply the surcharges. The railroads have established inter-carrier agreements to apply the origin carrier's fuel surcharge on through routes, even though the

⁵ STB Docket NOR 42117, *Cargill, Inc.; Exxon Mobil Corporation; Jones-Hamilton Co.; PPG Industries, Inc.; Reagent Chemical and Research, Inc. v. Aberdeen & Rockfish Railroad Company; Baltimore & Ohio Chicago Terminal Railroad Company; BNSF Railway Company; Boston & Maine Corporation; Buffalo & Pittsburgh Railroad, Inc.; Canadian National Railway; Canadian Pacific Railway; Cedar Rapids and Iowa City Railway Company; Central Washington Railroad Company; CSX Transportation Inc.; Elgin Joliet & Eastern Railway Company; Gary Railway Company; Indiana & Ohio Railway Company; Iowa, Chicago & Eastern Railroad Corporation; Iowa Northern Railway Company; Kansas City Southern Railway Company; Maine Central Railroad Company; Montana Rail Link, Inc.; New York Susquehanna and Western Railway Corp.; Norfolk Southern Railway Company; Pan Am Railways, Inc.; Portland Terminal Company; Rochester & Southern Railroad, Inc.; Sandersville Railroad Company; Springfield Terminal Railway Co.; Union Pacific Railroad Company; Association of American Railroads; RailInc.*

Board instructed the carriers to change their fuel surcharge programs to reflect actual fuel cost increases⁶, and even though fuel costs differ for each carrier.⁷

Further, since the railroads' fuel surcharge programs have been in effect since 2002, we believe the fuel surcharges should be subject to Board review and the real question is whether or not the carriers should continue to assess fuel surcharges.

It is reasonable to expect that fuel costs would have increased over the past nine years, even without a fuel crisis. Therefore, it is not reasonable for shippers to compensate the carriers for the total fuel cost increase that has developed since 2002. A potential alternative is to calculate the difference in fuel costs after factoring in the normal cost of inflation. Our analysis has shown that surcharges adjusted to reflect the normal cost of inflation would be reduced significantly (as much as 50%). This is a potential alternative that could be considered fair to both parties.

However, the real question is whether or not the fuel surcharge programs should apply at all since new base rates have been established and the railroads have rolled fuel surcharges into existing rates. STB Docket Ex Parte No. 661 should be re-opened; fuel surcharges should be subject to Board review.

⁶ Decision Notes, Surface Transportation Board Decision Document, EP 661-0, Rail Fuel Surcharges, p. 1 "(1) Stipulated that a carrier wishing to assess what purports to be a fuel charge would need to develop a means of computing the surcharge that is more closely linked to the increases of its fuel cost that is attributable to the movement to which the fuel surcharge is applied..."

⁷ Differences in fuel costs are confirmed in the railroads' quarterly fuel surcharge reports and in the annual R-1 financial reports to the Surface Transportation Board.

Application of Rates - In the course of working on projects for numerous clients, we have discovered that the railroads are not applying the lowest applicable rates on some moves. In every case when overcharges have been discovered, sales and marketing personnel on line with the customers initially defended the charges as billed, stating a contract is a contract. Ultimately, the overcharge claims were processed and collected. However, this seems to be an industry problem and it appears there is a lack of understanding on the part of railroad personnel that the customer is entitled to the lowest applicable rate.

To date, we have discovered overcharges from five of the Class I railroads. It is inconceivable that a rail carrier would expect a customer who commits and ships significant volumes to pay rates higher than the public rates. Higher contract rates cannot be justified unless there are special services provided for the contract moves that would warrant higher rates.

We respectfully request that the Board confirm the rule that the customer is entitled to the lowest applicable rate.

Routing Protocols - When the concept of routing protocols was first introduced by Canadian National in 2005, it seemed the objective was to improve operating efficiencies, and to develop a plan to operate over the most efficient routes. However, that is not always the case. The railroads have developed inter-carrier agreements and established routing protocols that increase miles, and are simply focused on giving the carriers their desired maximum line haul (sometimes the origin carrier receives the longer haul; on other moves the destination carrier has a longer haul, indicating there was some give and take in the carriers'

negotiations). More important, sometimes it seems the railroad is forcing a route with the objective to direct business to a preferred connecting carrier, thereby eliminating other competing carriers.

The railroads have confirmed policies regarding routing protocols and they have refused to quote through rates or Rule 11 rates via alternative interchanges, citing the need to comply with routing protocols. Rail shippers should have some control over routing their shipments, and the railroads should be required to quote rates for more efficient routes.

V. Summary

Competition in the railroad industry is inadequate and we commend the Board for initiating this proceeding. We need practical solutions, rules and processes that not only protect large shippers with the volumes and resources to pay the litigation costs for formal complaints at the STB, but we also need to find ways to protect the interests of small shippers.

The Board should initiate a proceeding to determine if any changes should be made to the reciprocal switching rules adopted in Ex Parte No. 445, and termination of reciprocal switching should be subject to Board approval.

We encourage the Board to review the AAR mileage equalization rules and charges as a potential unreasonable practice and the impact it has on all tank car owners and shippers.

The Board should re-open STB Ex Parte No. 661, Railroad Fuel Surcharges; the surcharges should be subject to Board review to consider potential changes or

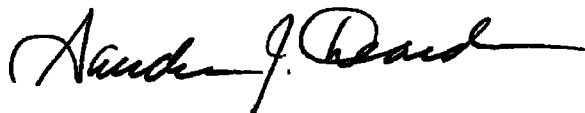
cancellation of the fuel surcharge programs. If a decision is made to continue the fuel surcharge programs, they should be subject to periodic review.

The Board should initiate a proceeding to determine if changes should be made to the bottleneck access rules and to address routing protocols as a potential unfair practice.

Finally, we are asking the Board to confirm the rule that rail customers are entitled to the lowest applicable rates.

I appreciate the opportunity to participate in this proceeding and I am prepared to assist the Board in their endeavor to address these very important issues.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Andrew J. Beard". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

June 10, 2011